DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 15428
San Diego, Calif. 92115

36 Letters per Year—$60.00 Annually

Registered with the Securities Exchange Commission

July 12, 1968 Letter 398

NOTE: Because this report covers the brief trading week which ended July 5 and the abbreviated following week, I have made this a four-page Letter rather than the usual six. Also, since I have not taken a vacation in a decade, I occasionally attempt to make things a bit easier for myself. I hope subscribers will excuse me.

THE MARKET: I believe that history will record the years 1966 (when the bull market which began in 1949 reached its peak, as measured by the D-J Averages) to 1968 as "freak years." Following the initial slide from the 1966 high of 995.15 to the later 1966 low of 744.32, the market embarked on a wild, inflation-inspired climb. On September 25, 1967, the Dow Industrials topped out at 943.08, exactly 52.07 points below the 1966 high.

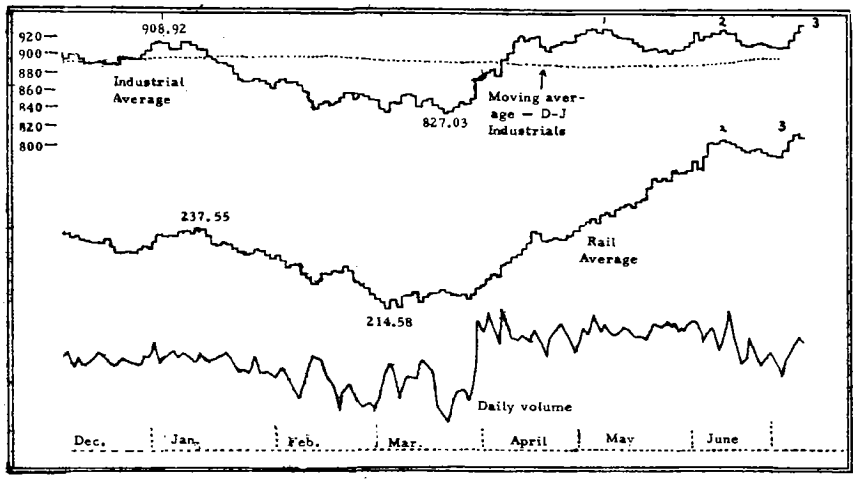
Despite the most frenzied speculation, the Dow has since failed to better the 943.08 high of 1967. Perhaps even more significant is that since the 1966 bull market top, only four of the thirty Dow Industrials have succeeded in recording new highs. This despite the fact that many secondary issues and "cats-and-dogs" have pushed through the roof.

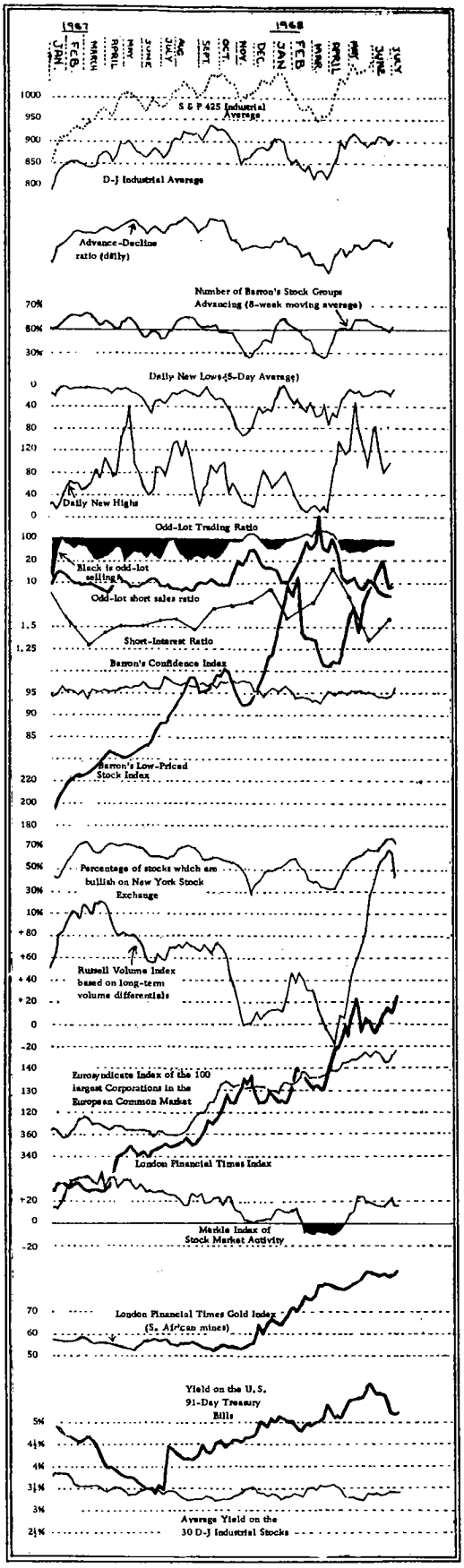
The war in Vietnam is now being negotiated, the tax bill has now passed, but neither of these events have caused the Dow to climb above its bull market (1966) high—or even its 1967 high. Actually, as seen on the page 1 chart, the Industrial Average is clinging rather tenaciously to the area of its 200-day moving average (the moving average now stands at 885).

In other words, despite much good news and despite a mass entrance of the public into every type of speculative equity, informed investors are now willing to pay only 30 or so more points for the Dow Industrial stocks than they were on average over the past 200 days. Bullishness regarding the 30 Dow stocks (whose value makes up 25% of the value of the entire N.Y.S.E.) has increased but little in the past 200 days.

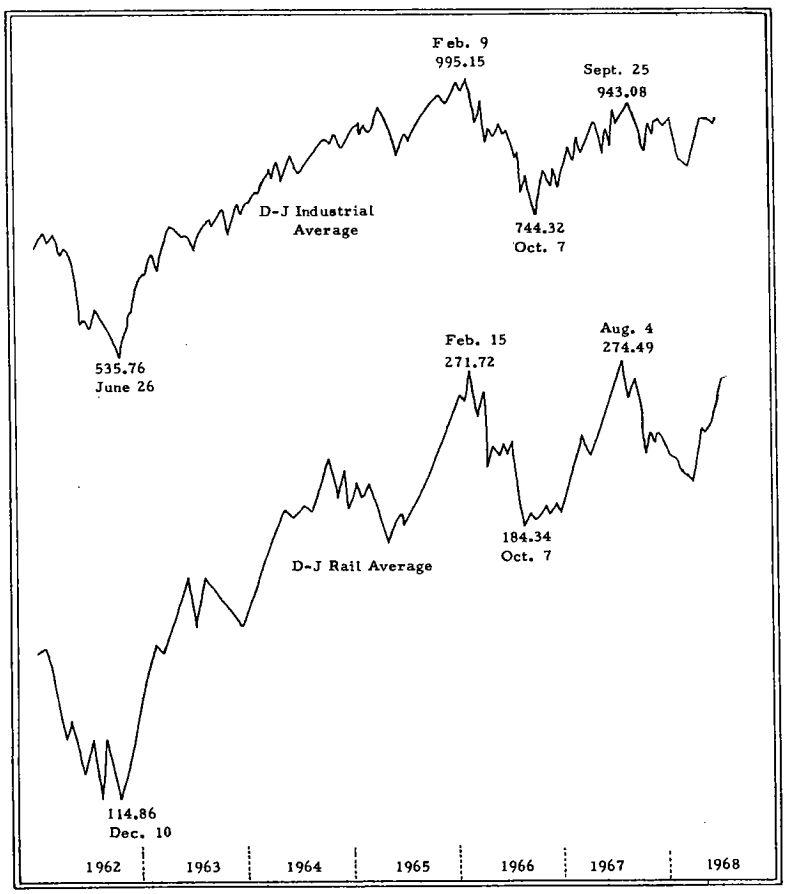
I call subscribers' attention to the following figures for the D-J Industrial and Rail Averages:

		Industrials	Rails
May	7	919.90	242.04
June	11	917.95	266.45
July	3	903.51	266.88




1967
1968
S & P 425 Industrial Average
D-J Industrial Average
Advance-Decline ratio (daily)
Number of Barron's Stock Groups Advancing (8-week moving average)
Daily New Lows (5-Day Average)
Daily New Highs
Odd-Lot Trading Ratio
Block is odd-lot selling
Odd-lot short sales ratio
Short-Interest Ratio
Barron's Confidence Index
Barron's Low-Priced Stock Index
Percentage of stocks which are bullish on New York Stock Exchange
Russell Volume Index based on long-term volume differentials
Eurosyndicate Index of the 100 largest Corporations in the European Common Market
London Financial Times Index
Merkle Index of Stock Market Activity
London Financial Times Gold Index (S. African mines)
Yield on the U.S. 91-Day Treasury Bills
Average Yield on the 30 D-J Industrial Stocks

These three dates are marked 1, 2 and 3 on the page 1 chart, and they of course signify that a period of divergence has been underway in the Averages. Since the joint May 7 peaks, Rails have recorded two successive highs, each unconfirmed (so far) by Industrials. If the divergence is to be wiped out, Industrials will have to close above their May 7 high of 919.90.



Now the interesting fact is that the two-month series of divergences as described above are important and dangerous enough. But the divergence since May 7 has occurred within another long-term series of non-confirmation, and this adds a second element to the current technical danger. Study the following figures:

	Industrials	Rails
February, 1966 peak	995.15	271.72
September, 1967 peak	943.08	274.49

This major or primary non-confirmation is graphically shown on the accompanying chart. Since August 4, 1967, the Industrials have failed to confirm the all-time high in the Rail Average. And then referring to the page 1 chart of the Averages we note that since May 7, 1968, Industrials have again failed persistently to confirm the successive series of intermediate highs (since May 7) in the Rail Average.

On a strict Dow Theory interpretation, this is a tenuous situation. Of course, the Industrials could always "catch on fire," and leap first above their May 7, 1968 peak of 919.90, thereby wiping out the divergence which has existed since early 1968. Industrials could then rise above their 1966 peak of 995.15, thus wiping out the divergence created by the August-September, 1967 non-confirmation. But so far, Industrials have not obliged, and until they do the Dow Theory will be saying that a highly dangerous series of non-confirmations and divergences exist.

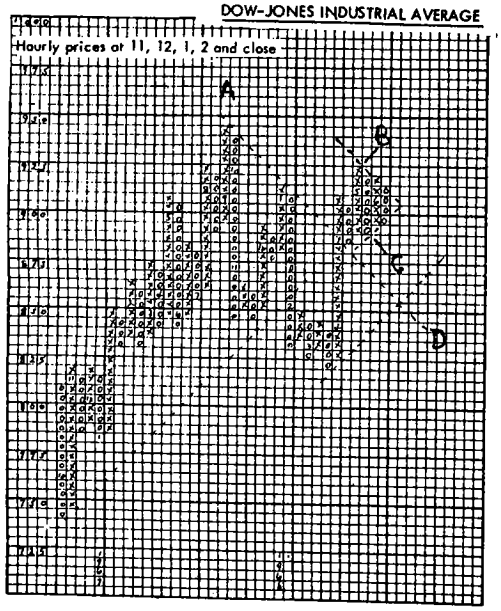
To put it another way, if a collapse were to occur over the next few months or so, market historians could study what I have written here and say, "But the Dow Theory was literally shouting 'danger'. How could anybody have missed it." Yet I have not seen a single other service allude to the long double series of non-confirmations and divergences which I have discussed in the foregoing paragraphs.

If the market does suffer a cave-in during late-1968 and 1969 most analysts will blame the drop on rampant speculation and pig-headed speculation. But the story is there in the pattern of the Averages. The market,historically, has not always responded to divergences and non-confirmations of the type which now appear in the pattern of the Averages. But when such divergences and non-confirmations do appear, it has usually proved sound practice to heed them. I feel that this is particularly true (1) when such danger signals occur within the framework of a primary bear market, which is now the case, and (2) when such danger signals are accompanied by huge volume and wild speculation, as now.

One of my colleagues (E. George Schaefer of Indiana) has just termed this ".....probably the most deceptive bear market that the American economy has ever spawned." Remember, for the first time since the Civil War we have had fiat money inflation or inflation without the discipline of gold. We have mass-media communication, which has brought perhaps 25 million people into the market. We have a Government dedicated to spending in all areas, a big-time (from the standpoint of expenses) war in progress, and a mountainous federal debt which is being financed at the highest interest rates in 100 years.

All this means that the impact of the bear market when it reasserts itself, will have "stored-up" energy. It will want to make up for lost time. Had the bear market which began in 1966 been subject to natural forces, it probably would be within a year of completion at this writing. But because every type of device and manipulation has come to play in an effort to hold off the bear forces, I feel that the ultimate bearish impact will be of greater duration and extent than is now thought possible.

POINT & FIGURE: Periodically I present point & figures analyses of the D-J Industrial Average. I find that P & F often provides clear, concise pictures of what may otherwise be a rather complicated study.



This is a 5-point, 15 point reversal chart by courtesy of Chartcraft, Larchmont, N.Y. What this means is that each box on the chart represents a full 5 points on the Dow. Vertical rows of X's indicate rallies, vertical rows of O's indicate declines. Only reversals of 15 points or more appear on this chart. In other words if the Dow rises to 940 a row of X's to 940 will appear. If the Dow then fluctuates between 940 and 930 no new chart figures will be entered. But if the Dow then drops to 920 (or more than 15 points) a row of O's will indicate a 20 point decline.

This whole process produces a compression which allows for perhaps two or three or more years of action to be recorded on a small chart.

Note that all the current action is occurring under the 945 box (marked A) which represents the 1967 peak. What we have now is a triangle, a triangle which produced a high at the 925 box (marked B) and a low at the 890 box (marked C).

The latest decline (vertical row of O's) started at 915 and touched a low at 900. For a clear bullish breakout we would need a rise in the Dow to 925 and preferably to 930. A move to 930 would take the Dow clear above the current consolidation.

On the other hand, a decline to 890 would provide a bearish P & F signal, and a further drop to 885 would take the Dow clear below the consolidation. Therefore, the two points to watch for decisive signals are 930 on the upside and 885 on the downside.

Perhaps significantly, the 885 level is exactly at the level of the 200-day moving average of the Dow (see earlier comments), so that any decline to or below 885 would, in my opinion, be doubly ominous.

There are two factors of significance which might be mentioned at this time. One is bullish, and that is that all action is taking place above the last major declining trendline. In other words, by rising above 890 a few months ago the Dow reversed a bearish trendline.

The other factor, which is bearish, is that currently only 40% of the Dow stocks are bullish. As a rule, in order to mount a strong advance, 50% or more of the Dow stocks should be bullish. A third factor to consider (and this is also bearish) is that Indicator Digest's study of the short interest ratio in the 30 Dow stocks is currently at .87, up only slightly from a very low April reading of .64. Indicator's studies suggest that any ratio below 1.0 is bearish for the Dow stocks. The short interest ratio for the Dow stocks has not held at this low a level since 1961.

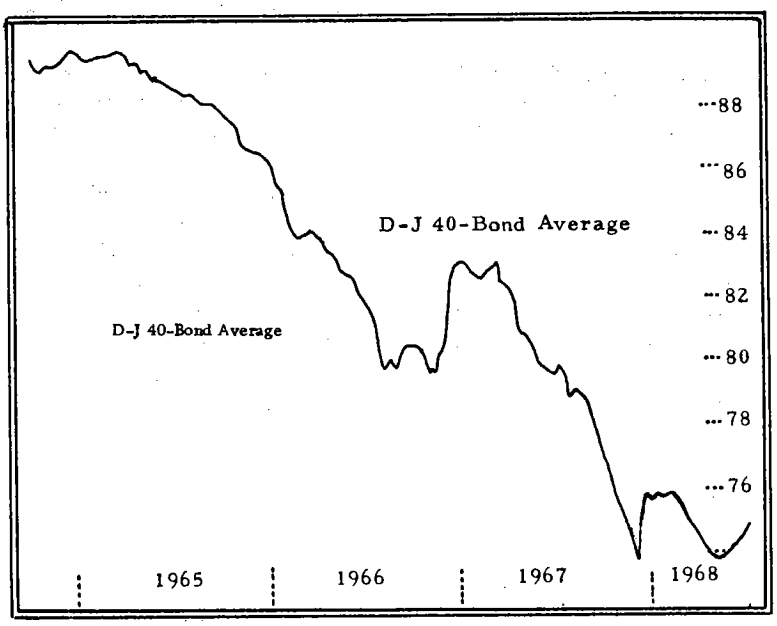
I have followed Indicator's Dow short interest ratio carefully, and I would say that so far it has been far more accurate in pinpointing strong and weak areas than has the generally accepted short interest ratio for the entire N.Y.S.E. (which is based on total average volume and the total short interest on the N.Y.S.E.).

TAXES AND MONEY: As seen on the composite page 1 chart (bottom) and on the accompanying page 4 chart, there has not, despite the passage of the tax bill, been any great rally in the general corporate bond market (or the Government bonds, for that matter).

I include the chart of the D-J 40 Bond Average because this Average is broadly based and is an accurate measurement of the trend of corporate bonds of all quality. Following the December 22, 1967 low of 74.62, this Average rallied feebly to a high in the 76 area in late-1967 and early-1968. A second decline took the 40-Bonds below 75 in the first quarter of 1968. Currently, the 40 bonds have advanced to the mid-75 area, a rather weak rally in view of the propaganda which has accompanied the 1968 tax bill.

Why are bonds still so reticent? For one thing, there are grave doubts as to whether the tax bill is going to put a damper on inflation. Since labor is being taxed as well as corporations, the unions will continue to ask for whopping

wage increases (to offset their diminishing take-home pay). Rising labor costs have constituted one of the prime sources of inflation. Next, as management gives in to labor (because of the right labor market), they will raise prices to offset the higher costs of wages. Thus, inflation promises to continue on its merry way.



The second big "phoney" in the tax bill is the promise that Federal expenses will be cut. So far, no one knows where they are to be cut except generally in the long-term defense program. It is clear that for political reasons, the poverty programs are not going to be cut, and there is every probability that they will be expanded during 1968 and 1969. But on the defense front, there is the competition to match the growing Russian naval (missile) strength, and there is the worry about an anti-missile program to cancel out China's rising missile capabilities. So whether defense programs are going to be eliminated is extremely doubtful.

All in all, many shrewd observers believe that the intended $6 billion Federal budget cuts are going to prove a massive fake. There is no doubt that LBJ had to produce the tax bill-budget cut package or face a run on U.S. gold from foreign Central Bankers.

As to actually cutting the budget, LBJ has left it up to Congress. But having ratified the tax bill, few students know how Congress is going to implement it by actually producing the budget cuts. Furthermore, LBJ is not going to be around in 1969 to put the pressure on Congress or to take the gaff from anyone who believes that the Government should live up to its promises.

The whole situation was presented classically by economist Elliot Janeway in his latest report: "Congress is just as realistic as the market: it has relieved itself of any charges of responsibility for 'fiscal irresponsibility;' and it can now scatter for the convention and the campaign, having done its part of the job, which Johnson made easy for it, and leaving the rest of the job, which is impossible, to be done by Johnson, who won't be there to finish it."

And that, I believe, is going to be the sad story of the budget cuts. And the bond market knows it.

LATE NOTES: On the July 9 closing, the D-J Industrial Average hurdled its May 7 peak of 919.90. The closing pirce of 920.42 (July 9) took the senior Average above its three preceding peaks as listed on page 1. The 920.42 price therefore wipes out the divergence which has existed since May 7.

From here on, as far as upside targets for the Dow, we have the 1967 high of 943.08 and the all time 1966 peak of 995.15. It remains to be seen whether the Dow, two years and five months after its 1966 bull market high, can muster the strength to approach the old peak again. I sincerely doubt that it can.

Turning to the page 2 chart, I would be particularly interested if the Rails now bettered their 1967 all-time high of 274.49 without a confirming rise by Industrials above either 943.08 or 995.15. A new Rail high above the 1967 peak would set up a new and important series of non-confirmations under classical Dow Theory.

LONDON: Over the past few months I have continually drawn parallels between the London and U.S. markets. I believe this clip from last week's Wall Street Journal is most illuminating Fear of paper money is driving the public into common stocks. On every side the public sees their government failing to stem the tides of inflation. Wages are rocketing, cost-of-living is rising, paper currencies the world over are under suspicion with numerous marginal currency devaluations occurring. As one leading expert put it in Barron's last week, "I think common stocks are the least unattractive place to be in the imperfect world in which we live." In other words, there is no perfect refuge from depreciating paper currency, but common stocks are at least an easy vehicle in the mass rush to swap paper money for stock certificates.

London Stocks Surge To High as Traders Try to Protect Funds

Financial Times Index Hits 484.1; Take-Over Bids Boost Volume; Boom Ignores Economic Gloom

By a WALL STREET JOURNAL *Staff Reporter*

LONDON—Prices bounded ahead on a wide front on the London Stock Exchange yesterday after a similar advance Wednesday. Trading was described as active both days.

The Financial Times index of 30 industrial stocks, which broke through to a new high Wednesday, moved up another 1.4 points yesterday to close at a record 484.1. The previous high was 482.9 set May 3.

Brokers said a resurgence of currency fears appeared to be the main impetus for the market's advance. "Investors, both the small trader and the big institution, apparently figured paper currencies aren't worth holding at the moment and are scrambling for stocks," one brokerage firm noted. Volume also was boosted by recent take-over bids and other favorable domestic corporate developments, one broker added.

Remarkably, the boom in the London market is taking place against a background of economic gloom in Britain—labor disputes, slipping currency reserves and continuing balance-of-payments problems.